NOTES

VOTING RIGHTS OF CREDITORS AND STOCKHOLDERS IN CHAPTER X REORGANIZATIONS

Circumstances sometimes make reorganization the preferable course for a corporation whose earnings are insufficient to improve its poor financial condition.[1] While continued operation under the present capital structure, coupled with deferral or reduction of expenditures not immediately essential, may be justified where increased earnings are in sight, prolongation of the *status quo* may be impractical if the future holds little hope for improvement of the firm's financial position or if the corporation is insolvent in the bankruptcy sense. Liquidation will forestall losses and free the assets of creditors and stockholders for more favorable investment, but, especially in a depressed market, forced sales may produce losses as severe as would result from continued operation. Not only may the creditors and stockholders suffer, the public may also be injured by withdrawal from the economy of a business unit which, but for past financial difficulties, could be profitably operated. If the corporation's difficulties may be corrected by a reorganization of the capital structure, the losses incident to liquidation may be avoided.[2] A reorganization may reduce fixed charges which are presently beyond the absorptive capacity of company income, or provide extension of time for payment of maturing debts which exceed existing liquid assets, or compromise creditors' claims where past losses have caused insolvency but future operations may be sufficiently profitable to permit discharge of the readjusted obligations and to improve the firm's position. Chapter X of the Bankruptcy Act[3] provides a statutory course of action for effecting recapitalization of corporations which can thereby be profitably operated as going concerns.

Although the current period of economic prosperity has occasioned a marked decline in the number and dollar volume of reorganization proceedings,[4] it seems advisable at this juncture to re-examine the adequacy of

1. See 6 COLLIER, BANKRUPTCY § 0.01 (14th ed. 1947) (hereinafter cited as COLLIER); Swaine, *Federal Legislation for Corporate Reorganization: An Affirmative View*, 19 A.B.A.J. 698 (1933).

2. See Case v. Los Angeles Lumber Products Co., 308 U.S. 106, 124 (1939).

3. 52 STAT. 883 (1938), 11 U.S.C. §§ 501-676 (1952) (Bankruptcy Act §§ 101-276).

4. See Securities and Exchange Commission annual reports, Nos. 5 through 20. For those reorganization proceedings in which the SEC participated, beginning in fiscal year ended June 30, 1939, the first year that chapter X became effective, there were 87 new proceedings involving 105 corporations having assets aggregating in excess of $550,000,000 and liabilities in excess of $440,000,000. 5 SEC ANN. REP. 9 (1939). During fiscal year ended June 30, 1940, there were 47 new proceedings involving the reor-

the machinery created to effectuate reorganizations. This Note will deal with those provisions of the act which specify the circumstances in which persons having interests in a debtor corporation can, by a vote, voice their reaction to a proposed reorganization plan.

THE BASIS OF VOTING RIGHTS

Prior to the enactment of reorganization statutes, the courts had attempted to afford corporations the opportunity for rehabilitation through equity receiverships.[5] These attempts proved inadequate, however, principally because there existed no judicial power to bind dissenters to a plan obliging them to continue in the enterprise.[6] The alternative of otherwise satisfying dissenting claims would often render impractical the proposal to continue operation of the firm. Section 12 of the Bankruptcy Act[7] did authorize binding of dissenters by voluntary compositions, but it provided no means of dealing with either secured claims or the rights of stockholders, and hence had but limited applications to incorporated debtors.[8] Combining the workable aspects of each of these otherwise ineffectual approaches, Congress enacted section 77B of the Bankruptcy Act,[9] which was made specifically applicable to corporations and provided that acceptance by a designated plurality of each class of claimants would bind dissenters within that class. These provisions were later re-enacted as part of the present chapter X.

Conflicting Interests and the Vote

Presumably reorganization will be undertaken only when it is believed that the debtor corporation can be rehabilitated into a profitable enterprise if freed of its burdensome capital structure. A necessary concomitant is that some contract rights existing prior to reorganization will be changed. For example, the interest rate on bonded indebtedness or the dividend rate on preferred stock may be reduced; a creditor's claim may be converted into an equity interest; security previously available to a participant may be reduced or removed entirely. In addition, it would not be unusual for

ganization of 63 corporations having assets aggregating in excess of $1,580,000,000 and indebtedness of $860,000,000. 6 SEC ANN. REP. 52 (1940). These figures declined by fiscal year ended June 30, 1956, to six new proceedings involving corporations whose assets were in excess of $15,500,000 and liabilities in excess of $16,800,000. 22 SEC ANN. REP. 172-73 (1956).

5. See 6 COLLIER § 0.04; FINLETTER, PRINCIPLES OF CORPORATE REORGANIZATIONS 1-21 (1937); 1 GERDES, CORPORATE REORGANIZATIONS §§ 10-13 (1936).

6. See 1 *id.* § 17. For succinct listing of other deficiencies of equity receiverships, see Dean, *A Review of the Law of Corporate Reorganizations*, 26 CORNELL L.Q. 537, 540 (1941).

7. Act of July 1, 1898, c. 541, § 12, 30 STAT. 549, now included as chapter XI of the National Bankruptcy Act, 52 STAT. 905 (1938), 11 U.S.C. §§ 701-99 (1952).

8. SEC, REPORT ON THE STUDY AND INVESTIGATION OF THE WORK, ACTIVITIES, PERSONNEL AND FUNCTIONS OF PROTECTIVE AND REORGANIZATION COMMITTEES pt. VIII, at 72-74 (1940) (hereinafter cited as SEC STUDY).

9. Act of June 7, 1934, c. 424, § 77B, 48 STAT. 911.

the face value of a creditor's claim or a shareholder's interest to be reduced or eliminated. Furthermore, the eventual capital structure and the changes wrought to achieve it in any given case will reflect the views of those charged with the responsibility of formulating the plan of reorganization. Since each plan is the product of varied judgments on which reasonable men may differ, it is unlikely in any instance that only one plan will be feasible and fair. As a result, it is to be expected that some participants will be disgruntled by the treatment accorded them under the plan. Some may prefer to maintain their *status quo ante* or to be paid for their claims and end their association with the enterprise. Others may be willing to have their interests altered, but disagree with the particular treatment accorded them or with the likelihood of the debtor's success under the proposed capital structure. Because a participant's interest can be substantially affected and there are reasonable alternatives as to the best plan of reorganization, it is essential that a means be afforded for expression of dissatisfaction with the proposed plan.

One forum in which a participant may air his grievance is before the court charged with approving the proposed plan. Chapter X provides for a judicial hearing after notice at which all those concerned with the debtor may present their views.[10] The judge may then approve or disapprove the plan, with or without modification.[11] The plan may be approved if, in the judgment of the court, it is the best method of reorganizing the debtor corporation. If primary consideration is given to the public's interest in effectuating reorganizations, a participant's opportunity to express his views might be limited to his day in court. However, it seems desirable to give greater weight to the interests of participants than to that of the public. Both creditors and stockholders may be given securities having attributes other than those they originally possessed, in an enterprise capitalized differently from that they originally entered. Their personal dictates may differ from the judgment of the court, and they should be accorded a more forceful weapon to achieve their desires—whether they want liquidation, a more acceptable plan of reorganization or continuation of the corporation as presently constituted. The freedom of an individual to select the form of his investment and the enterprise in which he will entrust his property is normally highly regarded in our society. Before resort is made to compulsion, it should first be ascertained whether satisfying the participants would subvert the interests of a larger group, and if so, how great an injury would result from disregarding the dissenters' wishes.

Congress chose to give participants who may be injured a forceful position and incorporated a voting provision in chapter X to accomplish this objective. Briefly stated, the procedure is as follows. After the judge

10. 52 STAT. 890 (1938), 11 U.S.C. § 571 (1952) (§ 171).
11. 52 STAT. 891 (1938), 11 U.S.C. § 574 (1952) (§ 174).

has approved a proposed plan as "fair, equitable, and feasible," a copy is submitted to the creditors and stockholders for acceptance or rejection by them in writing.[12] Acceptance is achieved by a vote of two-thirds in amount of the claims filed and allowed of each class of participating creditors, and, if the debtor has not been found insolvent, by a majority of each class of stockholders.[13] The voting privilege is not without limitation, however. In computing the required acceptances, the court may exclude the vote of any creditor or stockholder, or class of them, not affected by the plan,[14] or whose claims or stock are disqualified as not being voted in good faith,[15] or for whom payment or protection has been otherwise provided.[16] These limitations reflect a legislative judgment that the public interest is promoted by effectuating reorganizations and that certain claimants may be deprived of their vote in the interest of the public and other participants. Provision is also made for the alteration and modification of the plan even after its acceptance.[17] In such case, after the judge, pursuant to a hearing, approves the proposed change, though he finds that it materially and adversely affects the interests of creditors or stockholders, any party who has previously accepted the plan will be deemed to have accepted it as altered or modified unless he files a timely written rejection.[18] Once the judge confirms the plan as fair, equitable and feasible,[19] and substantial consummation takes place,[20] the plan may no longer be altered or modified if to do so would thereby materially and adversely affect the interests of participants.[21]

Constitutional Safeguards

In construing the voting provisions of chapter X, the conflicting interests must be balanced by the courts with a view to this legislative determination. Another factor that requires consideration is the extent to which the Constitution may limit congressional power to affect claimants' interests if they are not provided the safeguard of a vote. This question will have added significance if an adverse economic climate impels Congress to give greater weight to the public's interest in accomplishing reorganizations by eliminating entirely a vote of participants.

12. 52 STAT. 891 (1938), 11 U.S.C. § 575 (1952) (§ 175). The creditors and stockholders also receive "the opinion of the judge, if any, approving the plan . . .; the report, if any, filed in the proceedings by the Securities and Exchange Commission . . .; and such other matters as the judge may deem necessary or desirable for the information of creditors and stockholders."

13. 52 STAT. 892 (1938), 11 U.S.C. § 579 (1952) (§ 179).

14. 52 STAT. 884 (1938), 11 U.S.C. § 507 (1952) (§ 107).

15. 52 STAT. 894 (1938), 11 U.S.C. § 603 (1952) (§ 203).

16. 52 STAT. 895 (1938), 11 U.S.C. §§ 616 (7), (8) (1952) (§§ 216 (7), (8)).

17. 52 STAT. 898 (1938), 11 U.S.C. § 622 (1952) (§ 222).

18. 52 STAT. 898 (1938), 11 U.S.C. § 623 (1952) (§ 223).

19. 52 STAT. 897 (1938), 11 U.S.C. § 621(2) (1952) (§ 221).

20. 66 STAT. 431 (1952), 11 U.S.C. § 629(a) (1952) (§ 229(a)).

21. 66 STAT. 431 (1952), 11 U.S.C. § 629(c) (1952) (§ 229(c)).

Even though the bankruptcy clause of the Constitution has been interpreted to empower Congress to legislate in regard to corporate reorganizations,[22] the exercise of this substantive power is subject to the due process clause of the fifth amendment.[23] Accordingly, legislation may neither be arbitrary nor capricious, and must grant participants reasonable protection for their property.[24] In determining whether creditors and stockholders are constitutionally entitled to a vote, it is necessary to examine the protection available to them from any other existing or potential safeguards.

Of greatest importance in this regard is the requirement that the court, pursuant to a full hearing for which timely notice must be given, affirmatively find the plan "fair and equitable," both before it is submitted to participants for approval [25] and again, upon their acceptance, prior to final confirmation.[26] The statute does not define "fair and equitable," but the Supreme Court has ruled that Congress intended to give to that phrase its prior meaning in equity receivership practice.[27] "Fair and equitable" is therefore said to incorporate the doctrine of "absolute priority" [28] whereby no interest can share in a reorganization until every senior interest receives in cash or new securities the "equitable equivalent" of its full claim. If the holder of a junior interest contributes new value in property or cash necessary to the corporation, his participation to the extent of such contribution is not precluded.[29] Although there is some question as to how closely the courts have observed the letter of this doctrine,[30] "absolute priority" theoretically grants a claimant, in the relative order of his preference, full protection for the principal of his claim, for any interest accumulated thereon and for any loss of status due to the reorganization plan, to the extent that a capitalization of prospective earnings indicates that he has an existing claim against the corporation.[31] The court thus protects the value of a party's interest from majorities who, for expediency, may be willing to have the class surrender part of its claim. Additional protection is afforded by the requirement that the court find the reorganization plan

22. See Matter of Prima Co., 88 F.2d 785 (7th Cir. 1937); Grand Boulevard Inv. Co. v. Strauss, 78 F.2d 180 (8th Cir. 1935). Continental Ill. Nat'l Bank & Trust Co. v. Chicago, R.I. & P. Ry., 294 U.S. 648 (1935), although dealing with railroad reorganizations, settled the issue.

23. Louisville Joint Stock Land Bank v. Radford, 295 U.S. 555 (1935).

24. See Continental Ins. Co. v. Louisiana Oil Refining Corp., 89 F.2d 333 (5th Cir. 1937); Campbell v. Alleghany Corp., 75 F.2d 947 (4th Cir. 1935).

25. 52 STAT. 891 (1938), 11 U.S.C. § 574 (1952) (§ 174).

26. 52 STAT. 897 (1938), 11 U.S.C. § 621(2) (1952) (§ 221(2)).

27. See SEC STUDY 142-43.

28. See Case v. Los Angeles Lumber Products Co., 308 U.S. 106, 115-16 (1939).

29. *Id.* at 122; see Gilchrist, *"Fair and Equitable" Plan of Reorganization: A Clearer Concept*, 26 CORNELL L.Q. 592, 612 (1941).

30. See excellent discussion in Note, *Absolute Priority Under Chapter X-A Rule of Law or a Familiar Quotation?*, 52 COLUM. L. REV. 900 (1952).

31. See Consolidated Rock Products Co. v. Du Bois, 312 U.S. 510, 525 (1941); *In re* Inland Gas Corp., 211 F.2d 381 (6th Cir. 1954).

"feasible." Since this finding is drawn from an inquiry into the economic soundness of the proposed financial structure,[32] the court thereby protects claimants from unwarranted action by those who may be uninformed as to the advisability of alternative capital structures.

In determining the fairness and soundness of a proposed plan, the court is aided by the advice of the SEC.[33] Also, aside from judicial scrutiny, the act provides for administration of the reorganization by an independent trustee who, presumably, will be able to balance and protect the interests of all participants.[34]

A participant's rights would certainly be adequately safeguarded, in the "due process" sense, by the aforementioned provisions if the chief protector, the judge, with the assistance of the SEC, were able to perform the onerous task given him. Reorganization plans represent a delicate balancing between the various claimants which is not easy to achieve.[35] For example, when a holder of a $1,000 5% first mortgage bond is given in exchange a $700 4% debenture, a $300 5% income bond, a $200 6% preferred stock and five shares of common stock, has he received his "equitable equivalent"? Or has he received more than he is entitled to and thus left a junior claimant with less than his fair share? Can a judge, even with the advice of the SEC, decide in such a highly specialized and complex matter whether the parties have been fairly treated? Would it not be better to require the endorsement of a specified number of those who are in fact vitally concerned with the subsequent operation of the firm?

In similar legislation regarding railroad reorganizations, where acceptance by two-thirds of each class of creditors is also required, Congress has provided that a court may confirm a plan notwithstanding failure to obtain such acceptance if the court finds, among other things, that the creditors' rejection of the plan is not "reasonably justified."[36] The Supreme Court has indicated that this provision does not deny procedural due process, since full hearings are specified before the Interstate Commerce Commission and the lower court, with judicial review by the appellate courts.[37] This procedure was justified as no more arbitrary in the constitutional sense than a provision requiring a sale in a depressed market.[38]

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32. SEC STUDY 159-61; see Calkins, *Feasibility in Plans of Corporate Reorganizations Under Chapter X*, 61 HARV. L. REV. 763 (1948).

33. 52 STAT. 890, 894 (1938), 11 U.S.C. §§ 572, 608 (1952) (§§ 172, 208). See Frank, *Epithetical Jurisprudence and the Work of the Securities and Exchange Commission in the Administration of Chapter X of the Bankruptcy Act*, 18 N.Y.U.L.Q. REV. 317, 319 (1941).

34. 52 STAT. 888, 890 (1938), 11 U.S.C. §§ 556, 567 (1952) (§§ 156, 167).

35. See Frank, *supra* note 33, at 321-22.

36. 49 STAT. 1969 (1936), 11 U.S.C. § 205(e) (1952).

37. RFC v. Denver & R.G.W.R.R., 328 U.S. 495, 532 n.35, 533 (1946).

38. *Id.* at 509, 533. Even the dissent indicates only that Congress did not intend "to restrict the right of self-protection which it gave to railroad creditors," not that Congress could not have done so if it were desired. *Id.* at 548-49.

Similar reasoning would appear to sustain the constitutionality of a reorganization procedure which did not have the requirement of a vote. Although corporate reorganizations generally are not affected with the same degree of public interest as exists in the case of railroads, and participation by the SEC is merely advisory in the former whereas the ICC is charged with approving a plan in railroad reorganizations,[39] it is unlikely that these distinctions would be employed to hold chapter X unconstitutional in the absence of the voting provisions. The other surrounding safeguards appear sufficient. However, should Congress reconsider chapter X, the complexity involved in reallocating securities and the dimension of the participants' interests at stake make it desirable as a matter of policy that the participants continue to have a deciding voice on proposed plans.

DETERMINATION OF THE CLASSES AFFORDED A VOTE

Assuming the desirability of a vote by participants as an integral part of any reorganization statute, the next consideration is whether the privilege should be extended to all the shareholders and creditors of the debtor corporation or only to those whose relationship with the reorganized enterprise will be affected in some prescribed manner. Of pertinence here is the value to the public and interested parties of reorganizing a sick corporation. Granting a vote to a large group increases the possibility of disagreement and ultimate rejection of the proposed plan, thus lessening prospects of effectuating reorganization. Voting provisions are included essentially on the premise that the firm's capital structure and the revamped interests therein should reflect the self-interest of claimants. To the extent that the desirability of promoting reorganizations clashes with this premise, prime emphasis should be given to the interests of the participants, for the reasons previously discussed.[40] This can be accomplished by extending the voting privilege to all creditors and stockholders in the debtor corporation except those whose relationship with the debtor is terminated or unaltered by the proposed reorganization plan. Denying a vote to the latter classes, in order to promote reorganizations more effectively, is not inequitable in view of such claimants' tenuous interest or unchanged risk in the debtor.

The Need for Protection: A Functional Approach

Foremost among the classes not needing the protection of a vote are those not given an interest in the reorganized firm because there are no assets available for their claims after senior claimants are satisfied. As a practical matter, granting a vote to one whose claim is valueless would

39. After a plan is filed with the Commission and hearings are held, it shall approve a plan, which may be different from any proposed, or it may refuse to approve any plan. "No plan shall be approved or confirmed by the judge . . . unless the plan shall first have been approved by the Commission and certified to the court." 47 STAT. 1474 (1933), 11 U.S.C. § 205(d) (1952).

40. See p. 694 *supra*.

impede reorganization, if not render it impossible, for no claimant is likely to accept voluntarily a plan extinguishing his claim. It might be contended, however, that a valueless class should have the power to express preference for available alternatives which could be more favorable to it, such as an effort by the debtor corporation to accumulate further assets under the existing capital structure or a different reorganization value for the debtor which might increase the possibilities of the class' participation. But senior claimants will probably prefer liquidation to continuation of the firm as presently unsoundly capitalized, in which case the sole achievement of the valueless class' vote would be the defeat of a reorganization that might have benefited other claimants. As to the other alternative, if revaluation could give recognition to its claims the class would have a distinct interest in blocking a reorganization that granted it no participation. While the class could challenge the proposed plan as not "fair and equitable," the range within which a plan may be "fair and equitable" makes difficult the task of overcoming the risk of non-persuasion, so that without a vote the class may be unable to have its demands satisfied.[41] However, enabling the class to prevent reorganization seems too high a price to pay merely to protect some possible modicum of value for a group which, as to the plan being voted upon, has been judicially determined to be valueless.

Even though a proposed plan recognizes that the claim of a class has value, if the proposal relieves the class of its future dependence on the revamped firm the interest of the class in the capital structure and allocation of securities is not sufficient to award it a vote. For example, when the face value of a class' claim is satisfied by a cash payment there is no reason to accord it a voice in determining the new corporate structure, since the members will not be affected by the firm's future operation. Some members of the class may be reluctant to receive a cash payment if their investment was on more favorable terms than they may now obtain elsewhere. If a cash payment would compensate the participants for their favorable investment, they would have little reluctance for such a payment. In any event the appropriate forum for such an objection is the court, before which the amount of the payment may be challenged as denying the class the equitable equivalent of its prior claim. The additional protection of the vote is not needed, for the complex problems existing when a non-cash provision is made for a claim are absent here, and a judicial determination of value is considered adequate in most equity proceedings. Moreover, when a corporation needs reorganizing, many classes will be forced to make some sacrifices to attain the desired corporate structure. As a result, it is probable that a class receiving a cash payment will be satisfied so that solicitation of its vote would merely result in unnecessary

41. Particularly since appellate review will be based only upon whether or not there is evidentiary support to sustain the judge's findings on valuation. See, *e.g.*, *In re* Chicago Rys., 160 F.2d 59 (7th Cir. 1947).

added expense. Similarly, if the amount of the cash payment is to be determined by a judicial sale of specific property, or by appraisal of the claim where less than its face amount will be paid, no vote need be provided. Problems collateral to the valuation of such claims will be discussed in the next section.[42]

Instead of terminating a claimant's interest by a cash payment, the plan may transfer a creditor's claim to another firm together with property sufficient to satisfy the debt. Here, too, the proposal frees the creditor from any future dependence upon the capital structure of the corporation being reorganized. Objections to depriving the claimant of an opportunity to protect himself by a vote from losses subsequent to the transfer will also be considered in the following section.[43]

A vote should be afforded those claimants whose interest in the debtor corporation is significantly altered by the reorganization plan. Presumably among those most deserving a vote are claimants who will receive securities in the reorganized firm of a class different from that previously possessed, *e.g.*, an equity status substituted for that of a creditor. In addition, where the nature of the security remains the same, if there is a change in the covenants contained therein which materially modifies the claimant's rights, such as a reduction in the interest rate on bonded indebtedness or elimination of the cumulative feature on preferred stock, the security-holder seems entitled to a vote. Similarly, a vote seems appropriate for claimants whose interests are directly abridged by temporary restrictions on their rights, such as exist when a plan provides that under certain circumstances dividends will not be paid.

A more difficult problem arises where rights granted to other parties tend to restrict a claimant's previous economic advantage although none of the superior legal incidents of the latter's interest are disturbed. This occurs, for example, when a bondholder retains a prior lien against property sufficient to satisfy his claim, but additional property against which he, together with junior creditors, could previously have enforced his claim has now been made subject to a lien in favor of other claimants. Similarly, granting common stock to claimants previously having none tends to dilute an original common shareholder's control over, and dividend interest in, the revamped corporation. In cases of this type, the extent and remoteness of the injury resulting from the bondholder's loss of his "cushion" and the dilution of the common shareholder's interest are insufficient to justify granting a vote as additional protection. These classes will retain substantially what they had prior to reorganization and the sacrifice they are being asked to make seems insignificant in light of the value to the public of reorganization. Also, they are assured protection in being able to contest the plan as not "fair and equitable." Therefore, they should not be given the power, by means of a vote, to interfere

42. See pp. 707-08 *infra*.
43. See pp. 706-07 *infra*.

with reorganization, especially when other classes are willing to have their claims altered.

An additional problem exists as to voting rights of a junior class whose claim is not altered except for the fact that the participation it is granted is less than the full value of its claim because of the proposed valuation of senior claims. This situation raises questions similar to those involved in treating the claims of a valueless class, and for the same reasons there considered [44] it would seem that the class should not be afforded a vote.

The Present Statutory Treatment

Chapter X limits voting rights[45] to parties whose interest is "materially and adversely affected" [46] by a proposed plan, and specifically excludes those whose vote is not exercised in good faith or who are adequately protected in specified manners. This standard apparently was adopted to prevent obstruction of a reorganization plan by parties not injured thereby and to avoid the expense of conducting a vote of those who would probably accept the plan or at least have no significant reason for rejecting it. Construction of the terms "materially and adversely" has been left to the courts, apparently because it was considered undesirable or impractical to fix any rigid definition.[47] Unfortunately the terms have not as yet acquired a specific meaning in reorganization law, since the courts have not often encountered the problem, but to the extent that they have it would seem that the approach outlined above has been substantially followed.

Courts have always denied a vote when a claim is valueless because the reorganization value [48] of the corporation is insufficient to satisfy the party's claim after allocating the available assets among prior claimants. This result is specifically required by the statute in the case of shareholders in an insolvent corporation,[49] and it has also been reached by the courts without hesitation when dealing with junior creditors.[50]

44. See pp. 698-99 *supra*.

45. 52 STAT. 892 (1938), 11 U.S.C. § 579 (1952) (§ 179).

46. 52 STAT. 884 (1938), 11 U.S.C. § 507 (1952) (§ 107): "Creditors or stockholders or any class thereof shall be deemed to be 'affected' by a plan only if their or its interest shall be materially and adversely affected thereby."

47. See SEC STUDY 130 n.174.

48. The valuation of an enterprise for purposes of reorganization is arrived at by a capitalization of its prospective earnings. Consolidated Rock Products Co. v. DuBois, 312 U.S. 510 (1941). This proceeds from the theory that the value of a firm's assets reflects their utility measured in terms of the earnings their use will generate, capitalized at a rate of return commensurate to the risk attributable to the investment in question. 1 DEWING, FINANCIAL POLICY OF CORPORATIONS 276 (5th ed. 1953).

49. 52 STAT. 892 (1938), 11 U.S.C. § 579 (1952) (§ 179). Junior stockholders are denied a vote even in a solvent corporation if the assets are only sufficient to satisfy the claims of creditors and preferred shareholders. See, *e.g.*, *In re* Utilities Power & Light Corp., 29 F. Supp. 763 (N.D. Ill. 1939); *In re* National Food Products Corp., 23 F. Supp. 979 (D. Md. 1938).

50. In the Matter of 620 Church Street Bldg. Corp., 299 U.S. 24 (1936); *In re* Chicago Rys., 160 F.2d 59 (7th Cir. 1947); Wayne United Gas Co. v. Owens-Ill. Glass Co., 91 F.2d 827 (4th Cir. 1937) (alternative holding); O'Connor v. Mills, 90 F.2d 665 (8th Cir. 1937).

Courts have also denied a vote when a claimant is provided for in a manner which leaves him without dependence on the future capital structure of the enterprise. This result has uniformly been achieved when provision is made for the discharge of a claim by a cash payment in full.[51] Section 77B previously provided that a vote would be denied in such a situation, but this provision was dropped in chapter X as stating the obvious.[52]

Furthermore, a vote will be denied when the plan provides for payment of the claim at a value determined by appraisal[53] or in an amount derived through a judicial sale of property at a fair upset price,[54] or when a secured creditor's claim is satisfied by transfer of the property subject to such claim.[55] These methods are expressly recognized by the act as protecting a dissenting class sufficiently to disregard its objections.[56] It is, therefore, not surprising that Congress also declared a vote unnecessary for those claimants when such a provision is made for them as part of the original plan.[57] It may be argued that such parties should be given a vote when the plan is initially presented to them, since a showing of their displeasure could sponsor an alternative plan that would satisfy all participants; a dissenting class might still be compelled to accept such provision if the court has considered it unwise to change the plan. Notwithstanding the value of this alternative, the claimants' opportunity to present their arguments at a judicial hearing on the issue of whether the plan is "fair and equitable" seems adequate, and the additional protection of the vote, with the added expense it necessitates, seems unwarranted.

The main problems arise when claimants receive a share in the reorganized enterprise different in some respect from what they originally possessed. The basic difficulty is in determining the degree of substantiality and immediacy of injury which must be demonstrated before the courts will deem an interest "materially and adversely" affected.

Courts have never denied a vote when claimants are granted securities of a different class from that previously possessed[58] or when there are

51. See, *e.g.*, Knight v. Wertheim & Co., 158 F.2d 838 (2d Cir. 1946).

52. 6 COLLIER 3478.

53. *E.g.*, National City Bank v. O'Connell, 155 F.2d 329 (2d Cir. 1946).

54. *E.g.*, Country Life Apartments, Inc. v. Buckley, 145 F.2d 935 (2d Cir. 1944). This is a drastic example, for it actually effected a liquidation of the enterprise, as all classes of claimants were paid from the proceeds.

55. *E.g.*, *In re* Englander Spring Bed Co., 17 F. Supp. 15 (E.D.N.Y.), *aff'd mem.*, 86 F.2d 998 (2d Cir. 1936).

56. 52 STAT. 896 (1938), 11 U.S.C. §§ 616(7), (8) (1952) (§§ 216(7), (8)).

57. 52 STAT. 892 (1938), 11 U.S.C. § 579 (1952) (§ 179).

58. *E.g.*, *In re* Radio-Keith-Orpheum Corp., 106 F.2d 22, 25-26 (2d Cir. 1939). The act clearly indicates that the substitution of new securities would be a common provision of a reorganization plan. A plan "shall include in respect to creditors generally or some class of them, secured or unsecured, and may include in respect to

basic changes in the covenants of securities retained.[59] Similarly, it has been held that even the temporary abridgment of the rights of a class is sufficient to afford the class a vote.[60] When the effect on the claimant's interests is indirect, as in instances previously discussed of diminution of a security holder's "cushion" or dilution of a common shareholder's voting interest, no case reveals that the claimant has been afforded a vote. In the former instance, this result is specifically authorized by a statutory denial of the vote, representing a legislative determination that adequate protection of such an interest exists without a vote.[61] Even absent a specific statutory provision, it would seem that a vote should be denied at the point where the proposed plan allots to a class substantially what it had prior to reorganization, *i.e.,* the alteration of its existing claim will affect the class only remotely. That an alteration might be so negligible as not to be "material" is clearly contemplated by the statute. As a practical matter, however, it would seem that if the claims of a class are such that adjustments are needed in order to provide a workable capital structure, the changes will probably be of a material nature.

A correlative problem is raised by the statutory requirement that an interest be "adversely" affected before the claimant is afforded a vote. This could be read as denying a vote whenever, in the court's opinion, the overall effect of the plan is not adverse to the claimant's interest, *i.e.,* the claimant is to receive the equivalent of his claim in the revamped firm. Under the absolute priority rule this construction would deny a vote to every senior claimant, for he is entitled to the full value of his claim before junior interests can participate. One court did deny a class a vote on the modifications of a plan, on the ground that the proposed changes were on the whole beneficial to the class, although some obvious disadvantages were present.[62] A contrary result was reached by another court which

stockholders generally or some class of them, provisions altering or modifying their rights, either through the issuance of new securities of any character or otherwise. . . ." 52 STAT. 895 (1938), 11 U.S.C. § 616(1) (1952) (§ 216(1)).

59. *E.g.,* Kyser v. MacAdam, 117 F.2d 232 (2d Cir. 1941); *In re* Chain Inv. Co., 102 F.2d 323 (7th Cir. 1939).

60. See *In re* National Lock Co., 9 F. Supp. 432 (N.D. Ill. 1934). But one court denied a vote to common shareholders although the plan contained provisions whereby no dividends could be paid until the indebtedness was reduced to a certain sum and whereby the bondholders were allowed representation on the board of directors. The shareholders had obviously lost much of their previous ability to control the affairs of the corporation, a right which is fundamental in an equity investment. However, this case is not a strong precedent, for the common shareholders did not object and the court did not specifically deal with the issue. *In re* Anchor Post Fence Co., 14 F. Supp. 801 (D. Md. 1936).

61. 52 STAT. 896 (1938), 11 U.S.C. § 616(7)(a) (1952) (§ 216(7)(a)).

62. *In re* Celotex Co., 12 F. Supp. 1 (D. Del. 1935). The plan originally provided for a free grant to the financer of the reorganization of 15,000 shares of the common stock and a five-year option to buy 100,000 shares at $10. It was changed to grant him 25,000 free shares and an option to buy 50,000 shares at $6.66 within five days of the end of the period within which shareholders could subscribe. Though the reduction of the option in time and number of shares might prove beneficial in the long run, the immediate loss of 10,000 shares and the possible loss of nearly $3.50 a share in the option seem of dubious benefit.

held that judicial inquiry should end whenever substantial disadvantages are perceived, regardless of possible beneficial aspects of the whole plan.[63] If the voting privileges provided by Congress are not to be construed out of existence, the latter view is clearly preferable.

Treatment of a Dissenting Class

Should one or more classes fail to accept the reorganization plan as approved by the court, another plan may be formulated, presented for the court's approval and again offered to participants entitled thereunder to vote. This, of course, would entail a lapse of time, plus the additional expense of holding hearings and gathering votes. Also, it may be difficult to procure once more the acceptance of those who had previously agreed to the plan, since they may feel that the alterations and probable improvements in the provision for the dissenting classes were at their expense. Should submission of another plan appear to be useless, reorganization will not be achieved, unless there is some provision for compelling conformance by a dissenting class. There are two feasible methods for obtaining conformance: (1) permitting the court to overrule the wishes of the dissenting class, or (2) providing for the dissenters in a manner that would only slightly affect their interests so that their assent would not be required.

The Alternatives

The first method gives primary emphasis to facilitating reorganization. The court would be permitted to confirm any "fair and equitable" plan, notwithstanding dissenting classes, either at its own discretion or, as in railroad reorganizations, whenever it finds after a full hearing that rejection is not "reasonably justified."[64] Railroads, however, present a special situation to justify such a provision—public interest demands that rail service be uninterrupted by financial distress. Our concept of economic freedom normally involves permitting an individual to select the investment of his choice, in a firm whose capital structure he is willing to accept. In corporate reorganizations, the very reasons that require a vote initially make it desirable to give more consideration to the participants' preferences, especially where an expert administrative body assumes only an advisory role.

More consonant with this approach is the second method, compelling participation of dissenting classes in the plan only in circumstances which negate or limit the possibility of their being injured. Two such circumstances may be specified. The first is where the plan retains the dissenting class in the reorganized corporation, leaving it to risk the success of the new capital structure. Logically, this should be done only if the class

63. *In re* National Lock Co., 9 F. Supp. 432 (N.D. Ill. 1934).

64. See text and citation at note 36 *supra*.

retains substantially what it had prior to reorganization and thus is not "materially and adversely" affected by the recapitalization.[65]

A second circumstance justifying compulsory participation is where the claimant's interest in the corporation is terminated, as by a transfer of the property which secures the dissenting creditor's claim, subject to such claim, or by a cash payment for the value of his claim. Cash payments raise the troublesome question of the proper valuation of the claim involved. Some authorities have considered that a dissenting class, having once refused to participate in a "fair and equitable" plan, could properly be given the liquidation value of its claim.[66] This presupposes that a "fair and equitable" plan could establish one valuation for claims of assenting classes and another for those of dissenting classes. Since liquidation value for some claimants could be less than the reorganization value of their claims, using the former value in paying off dissenters would tend to force such a class to approve an undesired plan rather than chance receiving a lesser sum for its claims. On the other hand, using reorganization value when the dissenter's claim is to be satisfied by a cash payment makes such an alternative more advantageous than remaining in the corporation, since the projected value is received without risk. As a result, this prospect may create an incentive for the claimant to reject the plan. However, it is unlikely that the claimant would reject a plan merely in the expectation of receiving a cash payment, since he is not assured of a cash payment and he may dislike the alternatives thereto. A new plan may be proposed granting him an interest in the revamped firm which he may not refuse if it does not "materially and adversely" affect him. On the other hand, his rejection may render reorganization impossible so that the debtor may have to be liquidated. The existence of such alternatives tends to reduce the likelihood that the possibility of a cash payment will be a real incentive to reject the plan. Therefore, adequate protection of the claimant's interest dictates that his claim be valued as it would be if he remained in the reorganized corporation.[67]

Compulsory Participation Under Chapter X

The solution adopted by chapter X is that of prescribing specific proposals which a class can be compelled to accept if these proposals are either originally included in the reorganization plan or later offered in lieu

65. See pp. 702-03 *supra*. An alternate solution might permit some classes to be considered "materially and adversely affected" for the purpose of expressing an initial preference, but nevertheless subject to having the provision of the plan forced upon it in the event it fails to accept and the judge finds that there is no other comparable plan. This alternative would not be a substitution of judicial discretion for that of the interested parties, but merely enforcement of an originally legislative determination of the specific circumstances in which the slight possibility of injury to dissenting classes does not counterbalance the need for reorganization.

66. See Gerdes, *General Principles of Plans of Corporate Reorganization*, 89 U. PA. L. REV. 39, 52-53 (1940).

67. See Frank, *Some Realistic Reflections on Some Aspects of Corporate Reorganizations*, 19 VA. L. REV. 698, 716-18 (1933).

of a rejected proposal. Section 216(7) states that a dissenting class of creditors shall be provided "adequate protection for the realization . . . of the value of their claims" by:

> "(a) . . . the transfer or sale, or by the retention by the debtor, of such property subjected to such claims; or
>
> (b) by a sale of such property free of such claims, at not less than a fair upset price, and the transfer of such claims to the proceeds of such sale; or
>
> (c) by appraisal and payment in cash of the value of such claims; or
>
> (d) by such method as will, under and consistent with the circumstances of the particular case, equitably and fairly provide such protection."[68]

Methods identical to (b), (c) and (d) are specified in subsection 216(8) for providing stockholders "adequate protection for the realization . . . of the value of their equity, if any." [69]

Preserving the Claim and Collateral

Generally, subsection 7 (a) adequately protects dissenting creditors, since the full amount of the claim is preserved and reinforced by collateral.[70] Should the value of the security allocated to the class fail to cover its entire claim, the balance of the claim would be classified as unsecured and the claimants treated as general creditors to the extent of the unsecured balance.[71] Thus, if the claim was previously secured, the claimants' position in regard to their primary security is not altered.

However, their position may not be identical as to the unsecured portion of their claims. When the property subjected to creditors' claims is retained by the debtor, the cushion previously available to these creditors in the form of "free assets" against which they might have satisfied their claims had their primary security been insufficient may no longer be available. Previously unsecured creditors may have been given a security interest in this property or it may have been used to satisfy other claims. Similarly, when property is transferred subject to the creditors' claims, the creditor loses his original right to proceed against the debtor for any deficiency. One court has labeled this objection merely theoretical.[72] It would seem, however, that when the value of the property barely matches the claim, the injury that could result from possible changes in the value

68. 52 STAT. 896 (1938), 11 U.S.C. § 616(7) (1952).
69. 52 STAT. 896 (1938), 11 U.S.C. § 616(8) (1952).
70. See SEC STUDY 130.
71. 52 STAT. 893 (1938), 11 U.S.C. § 597 (1952) (§ 197).
72. Central States Life Ins. Co. v. Koplar Co., 85 F.2d 181, 184 (8th Cir. 1936).

of the security through depreciation or price fluctuations, especially in the hands of a debtor who is not considered a good credit risk, should be recognized as more than theoretical.

If such risks are present, the dissenting creditor can probably contest the proposal as not "fair and equitable" or as failing to grant him "adequate protection for the realization . . . of the value" of his claim.[73] Recognizing the emphasis placed on permitting interested persons to shape the reorganization, a proper interpretation of chapter X would require examination of the possible injury that could result to one who is forced to accept the proposal. It would appear, however, that a creditor contesting the use of subsection 7(a) should demonstrate that there is a likelihood, rather than a mere possibility, of a loss; otherwise utilization of this provision to effectuate reorganization could be undermined.

As a practical matter, subsection 7(a) has limited significance. The debtor will probably be in need of all of its property and therefore unable to transfer or sell it. At the same time, retention of the property subject to an unaltered claim will accomplish little toward reduction of fixed charges which may have created the need for reorganization in the first place.[74]

Payment Upon Judicial Sale or Appraisal

The judicial sale at a "fair upset price," now available only to protect whole classes of dissenters, is a carry-over from equity receivership, where it was used to protect dissenters within a class.[75] This provision also is of limited usefulness, since expenditure of the property or cash needed to satisfy an entire class may render reorganization impracticable. Especially is it of doubtful utility in dealing with large claims, or with those of senior creditors entitled by the "absolute priority" rule to complete compensation before satisfaction of junior claims.[76] If the claims of the dissenting class are small, either because they originally were so or because they are junior claims whose reorganization value is less than face value, it is possible that sufficient assets could be marshalled to satisfy the claims without endangering the success of the revamped corporation.[77]

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73. Graham, *Fair Reorganization Plans Under Chapter X of the Chandler Act,* 8 BROOKLYN L. REV. 137, 146 (1938); 6 COLLIER 3482. The "fair and equitable" argument could probably also be raised by senior creditors whose claims are altered if junior claims are retained under § 7(a). See 6 COLLIER 3495; SEC STUDY 131.

74. See Note, *Provisions for Non-Assenting Classes of Creditors in Bankruptcy Reorganizations,* 46 YALE L.J. 116, 119 (1936).

75. See SEC STUDY 138.

76. *Id.* at 135-38.

77. This provision has also been used to effect a liquidation, with all claimants being paid from the proceeds of the judicial sale. See, *e.g., In re* Chicago Rys., 160 F.2d 59 (7th Cir. 1947); Country Life Apartments, Inc., v. Buckley, 145 F.2d 935 (2d Cir. 1944). A similar result has been reached by the courts without mention of voting rights under § 216(10), 52 STAT. 896 (1938), 11 U.S.C. § 616(10) (1952): "A plan of reorganization under this chapter—(10) . . . may include . . . the sale of all or any part of its property, either subject to or free from any lien, at not less than a fair upset price. . . ." See *In re* Lorraine Castle Apartments Bldg. Corp., 53 F. Supp. 994 (N.D. Ill. 1944).

The appraisal method for satisfying dissenters was at one time alleged to deny due process.[78] The Supreme Court, however, has upheld the constitutionality of a similar provision under section 75(s),[79] dealing with the farmer-debtor,[80] and of the appraisal provision applicable to railroad reorganizations.[81] Today, appraisal, subject to judicial approval and review, is considered no more arbitrary or lacking in procedural safeguards than a judicial sale itself.[82] It is, however, subject to the same practical limitations as the judicial sale. As a result, resort has been made to this method mainly when a class' claims have been appraised as worthless,[83] and only occasionally when the class has been paid the appraised value of its claims.[84]

"Equitable and Fair" Protection

The scope of the omnibus grant of subsection 7(d), and in the case of stockholders subsection 8(c), is explicitly limited by the phrase "equitably and fairly," which is interpreted to incorporate "absolute priority." [85] Hence, it cannot be used to scale down senior interests for the benefit of junior claimants, although it seems certain that this would be true even without an explicit provision.[86] The broad language of this provision would seem to enable a court to impose almost any plan on a dissenting class. Unlike the first three provisions, it does not expressly require either that the claimant's position remain substantially unchanged or that he be paid off. The only significant limitation placed upon the use of this subsection is the condition applicable to each of these methods, that there be provided "adequate protection for the realization" of the participant's interest. If emphasis is placed on "realization," the only proposals authorized by this subsection are those that will provide complete compensation at the time of reorganization.[87] Unless the term "realization" were given that controlling meaning, theoretically it would be possible that under this provision a court could obviate the requirement of a vote for any class, so long as the plan was "fair and equitable"—a result obviously not intended by Congress.[88]

78. See *In re* Preble Corp., 12 F. Supp. 1002 (D. Me. 1935), *aff'd sub nom.* Preble Corp. v. Wentworth, 84 F.2d 73 (1st Cir. 1936) (only on the ground that the plan was not fair and equitable); *In re* Tennessee Publishing Co., 81 F.2d 463 (6th Cir.), *aff'd sub nom.* Tennessee Publishing Co. v. American Nat'l Bank, 299 U.S. 18 (1936) (determination of the constitutionality issue held premature).

79. 49 STAT. 943 (1935), as amended, 11 U.S.C. § 203(s) (1952).

80. See Wright v. Union Central Life Ins. Co., 311 U.S. 273 (1940).

81. See, *e.g.*, RFC v. Denver & R.G.W.R.R., 328 U.S. 495 (1946).

82. *Id.* at 509.

83. *E.g.*, In the Matter of 620 Church Street Bldg. Corp., 299 U.S. 24, 27 (1936); *In re* Hotel Governor Clinton, Inc., 96 F.2d 50 (2d Cir. 1938).

84. *E.g.*, National City Bank v. O'Connell, 155 F.2d 329 (2d Cir. 1946).

85. SEC STUDY 134.

86. 6 COLLIER 3507. See text and citations at note 69 *supra.*

87. See Texas Hotel Securities Corp. v. Waco Development Co., 87 F.2d 395 (5th Cir. 1936); *In re* Murel Holding Corp., 75 F.2d 941 (2d Cir. 1935).

88. See *In re* Granville & Winthrop Bldg. Corp., 87 F.2d 101, 103 (7th Cir. 1936).

The sole occasion on which a court has employed this subsection was a case in which the reorganization plan provided for full payment of the claims of mortgage bondholders, with the reservation that the court would later determine set-offs and defenses to the payment. The appraisal provision was relied on as authority for this proposal. The court indicated that if the appraisal provision was not wholly applicable, the proposal in any event constituted adequate protection under subsection 7(d).[89]

It is arguable that this omnibus provision may also be utilized to compel members of a class to accept securities whose fair market value is equal to the reorganization value of their claims. Since these claimants have the privilege of disposing of the new securities, at which time they will realize "complete compensation," they would seem to be adequately protected. If there were a probability that the market value would equal the reorganization value of their claims, there would be no objection to this proposal. However, it is more likely that the market for securities in the revamped corporation will be depressed, and thus the reorganization value of the claims will exceed the securities' market value. Since market value, by definition, will be unknown until the plan is effectuated and the securities issued, extending this subsection to sanction such a proposal would be erroneous. Furthermore, since virtually the only instance in which a vote would be granted is when new securities are given to the participants, use of the omnibus clause to foreclose a vote would be improper.

Although there may be some circumstances where this provision could be used to force dissenting classes to participate in a reorganization,[90] the courts will more likely resort to the omnibus provision only when there is doubt as to the applicability of the other subsections. At best, therefore, this provision will be used as alternative authority for approving hybrid proposals which would probably be approved even if the clause were not present. On the other hand, if its broad language were applied literally, it is possible that the voting privilege so generously granted by section 179[91] would be retracted. Elimination of the clause entirely would safeguard a proper application of the over-all statutory design.

As a general rule, the rehabilitation of a debtor corporation so that its future operations may be successful requires material changes in the interests possessed by participants. Congress has elected to defer in large measure to the preference of participants with regard to the plan of reorganization and to force participation only under circumstances in which a party's interests are not materially affected. The result is that the specific provisions compelling participation are operative in only a limited number of practical situations. Unless economic conditions require

89. National City Bank v. O'Connell, 155 F.2d 329 (2d Cir. 1946).

90. See 6 COLLIER 3507.

91. 52 STAT. 892 (1938), 11 U.S.C. § 579 (1952).

more and swifter reorganizations, the narrow range of applicability of the present provisions seems justified by the desirability of granting participants a significant voice in determining the reorganization scheme.

Disqualification of the Vote: The Good Faith Requirement

The preceding discussion has revealed the power that can be exerted by the vote, either in binding minority dissenters within a class when the required plurality accepts a plan, or in upsetting the proposed plan when rejecting it in an effort to block reorganization or to force the plan's proponents to grant the class more favorable treatment. Such power is granted in the belief that participants, voting in their own self-interest, will at the same time promote the best interests of their class. When a claimant has an ulterior motive in considering a given proposal, so that his vote would not reflect solely the protection of his own and his class' interest in the corporation, some limitation should be placed on the power accorded to him. The most rational solution is simply to disqualify such votes, permitting only those of properly motivated participants to govern.[92]

In demarcating improper motives, a problem arises when a party is a member of more than one class. To the extent that his action with regard to the proposal for one class may reflect his evaluation of the provisions made for his other holdings, his vote in at least one class will not be motivated solely by his interests as a member of that class. There would, however, be much practical difficulty in attempting to force an individual to examine his holdings with great impartiality and vote differently as a member of each class. One alternative is to deny a vote to any claimant who has an interest in more than one class, but while this may assure that votes reflect only the interests of each respective class, it hardly seems equitable in view of the significant interests which the voting right is designed to protect. It would, therefore, be more appropriate to permit every claimant to express his preference on the basis of the totality of his interest in the debtor. A more serious conflict exists where a party has some interest, apart from that of a mere participant in the debtor corporation, which he may be tempted to serve by exercise of his voting power. Since the implementation of his preference may be incompatible with the interests of his class and the corporation, disqualification appears proper.

In any event, the fact that an interest was purchased immediately before or even during reorganization proceedings suggests a need for closer scrutiny

92. An alternative would be for the court to tally the votes improperly motivated but to reverse the preference expressed thereby. This solution cannot merit serious consideration, for it must be premised on the assumption that a proper motive would have resulted in an opposite vote, an assumption having no basis in fact. Moreover, this procedure could lead to a result disagreeable to the requisite plurality of the class, computed either with the disputed votes as cast or with such votes disqualified. A similar solution was rejected in *In re* P-R Holding Corp., 147 F.2d 895 (2d Cir. 1945). The court there held that the affirmative votes of interest purchased in bad faith would be disqualified, but the prior negative votes would not be reinstated.

of the participant's motives. The presence of this factor alone should not be conclusive, since such acquisition might be motivated by a voter's desire to protect his other holdings in the corporation or a similar proper purpose. In addition, to prevent a recently purchased interest from voting could result in freezing all holdings in the debtor corporation, since few purchasers may be willing to leave the fate of their investment in the judgment of others. Thus restricting the alienability of such interests without additional evidence that the purchaser was improperly motivated seems undesirable. Similarly, any rule which would disqualify a party's vote merely because he acquired his interest for an abnormally high or low price would also seem to restrict improperly the alienability of claims. The amount a purchaser will pay would seem to be evidentiary more of the degree of his desire than of the impropriety of his motive. The payment of an abnormal price should therefore be considered as only an additional factor in the determination of good faith.

The present statute provides that in determining whether a plan has been accepted, the judge may, after hearing upon notice, disqualify those votes not cast in good faith, in light of or irrespective of the time of acquisition.[93] This provision has enabled the courts to cope with situations with which they had not been authorized to deal under section 77B. Under the previous statute, judicial review of disqualifying circumstances was restricted mainly to instances where an interest was purchased under circumstances amounting to fraud or violation of a fiduciary duty.[94] In such circumstances the court could either disqualify the vote entirely or reduce it to represent only the amount actually paid for the interest. However, the language of section 77B forced the courts to limit investigation to votes cast in favor of the plan.[95] The House hearings show that the present provision was intended to prevent attempts of participants "by the use of obstructive tactics and of hold-up techniques to exact for themselves undue advantages" [96] or "some particular preferential treatment, such as the management of the company." [97]

As was to be expected, the "good faith" section has not been used to disqualify a voter merely because he has more than one holding in the corporation. Although in two cases the argument was made that the acceptance of a plan by senior claimants was colored by its benefit to their added junior interest, in neither case were the votes disqualified.[98]

93. 52 STAT. 894 (1938), 11 U.S.C. § 603 (1952) (§ 203).

94. 6 COLLIER 2880.

95. See, *e.g.*, Texas Hotel Securities Corp. v. Waco Development Co., 87 F.2d 395, 400 (5th Cir. 1936).

96. *Hearings Before the Committee on the Judiciary of the House on H.R. 6439*, 75th Cong., 1st Sess., ser. 9, at 180 (1937). See Young v. Higbee Co., 324 U.S. 204, 211-12 (1945).

97. *Hearings, supra* note 96, at 182.

98. First Nat'l Bank v. Poland Union, 109 F.2d 54 (2d Cir. 1940) (plan held not to be "fair and equitable"); *In re* Radio-Keith-Orpheum Corp., 106 F.2d 22, 26 (2d Cir. 1939) (plan confirmed as "fair and equitable").

This section has been invoked almost exclusively in situations where the claim or stock in issue was purchased during reorganization proceedings. However, since the act specifically states that the time of acquisition is only a factor which may be considered and is not by itself a ground for disqualification, the courts have required the presence of an ulterior motive, that of advancing an interest other than the purchaser's legitimate stake in the enterprise.[99] The scanty case law reveals no instance in which such an ulterior motive was discovered, although in one case the court did disqualify certain votes. There, the dubious explanation was that the price paid by the purchaser discriminated in favor of the sellers, since they received more than the amount which was to be allocated under the plan to participants of a similar class.[100] Another court recognized that payment of an excessive price does not establish the existence of an ulterior motive, since a high price might result equally from an urgent desire to protect one's legitimate interests as from a bad faith attempt to affect a proposed reorganization plan.[101]

The mere presence of the "good faith" provision, if not its actual use in appropriate cases, serves the useful function of balancing two objectives. It offers a reasonable standard by which the power possessed by participants through the exercise of their vote may be curbed for the well-being of the debtor corporation and the remaining claimants. At the same time, it preserves this power for those who will use it in the best interest of the debtor corporation and their individual claim therein.

CONCLUSION

Although to date there has been a relative absence of litigation concerning chapter X's voting provisions, this is readily explainable on several grounds: (1) When claims are altered pursuant to a reorganization plan, previously existing interests are, of necessity, normally "materially and adversely" affected thereby. (2) Since the reorganized corporation will almost always be in need of most of its assets, only rarely can the "adequate protection" provisions be utilized to deny a vote or to compel participation. (3) The operation of the "good faith" section is factually limited to circumstances which do not occur frequently. (4) The voting provisions, as enacted and interpreted, do not present difficult problems of construction which might be conducive to litigation.

This scarcity of litigation does not signify that the voting provisions have an unimportant role in the statutory reorganization scheme. As has been demonstrated, they do grant to many participants additional

99. *E.g., In re* Pine Hill Collieries Co., 46 F. Supp. 669 (E.D. Pa. 1942). Regardless of motive, however, one court disqualified some acceptances which were obtained through *sub rosa* dealings. *In re* Fuller Cleaning & Dyeing Co., 118 F.2d 978 (6th Cir. 1941).

100. *In re* P-R Holding Corp., 147 F.2d 895 (2d Cir. 1945).

101. *In re* Pine Hill Collieries Co., 46 F. Supp. 669, 672 (E.D. Pa. 1942).

protection without unduly obstructing the basic objective of effectuating reorganizations. However, since the Constitution does not demand the inclusion of the vote in a reorganization statute, at least so long as other safeguards of the participants' interests are present, the existing deference to the judgment of participants is not necessarily permanent. Future changes in our socio-economic structure may dictate a shift to a statutory scheme which would emphasize the role of the court or an administrative body as the chief protector of the interests of participants and the public.

M. A.